

1 **DIRECT TESTIMONY**
2 **OF**
3 **JAMES R. DITTMER**
4
5 **ARIZONA PUBLIC SERVICE COMPANY**
6 **DOCKET NO. E-01345A-03-0437**
7

8 Q. Please state your name and address.

9 A. My name is James R. Dittmer. My business address is 740 Northwest Blue
10 Parkway, Suite 204, Lee's Summit, Missouri 64086.

11
12 Q. By whom are you employed?

13 A. I am a Senior Regulatory Consultant with the firm of Utilitech, Inc., a
14 consulting firm engaged primarily in utility rate work. The firm's engagements
15 include review of utility rate applications on behalf of various federal, state and
16 municipal governmental agencies as well as industrial groups. In addition to
17 utility intervention work, the firm has been engaged to perform special studies
18 for use in utility contract negotiations.

19
20 Q. On whose behalf are you appearing?

21 A. Utilitech, Inc. has been retained by the Utilities Division Staff ("Staff") of the
22 Arizona Corporation Commission ("ACC" or "Commission") to undertake a
23 review of what would commonly be referred to as the "traditional" rate base and
24 operating income statement components of Arizona Public Service Company's
25 ("APS" or "Company") retail electric cost of service study. Additionally,
26 Utilitech personnel are responsible for assisting in the quantification, and

1 incorporating the recommendations, of other ACC Staff witnesses and co-
2 consultants. Thus, the testimony that I am presenting is offered on behalf of the
3 ACC Staff.

4 5 **QUALIFICATIONS**

6 Q. Before discussing in greater detail the issues and various recommendations that
7 you will be addressing, please state your educational background.

8 A. I graduated from the University of Missouri - Columbia, with a Bachelor of
9 Science Degree in Business Administration, with an Accounting Major, in 1975.
10 I hold a Certified Public Accountant Certificate in the State of Missouri. I am a
11 member of the American Institute of Certified Public Accountants, and the
12 Missouri Society of Certified Public Accountants.

13
14 Q. Please summarize your professional experience.

15 A. Subsequent to graduation from the University of Missouri, I accepted a position
16 as auditor for the Missouri Public Service Commission. In 1978, I was
17 promoted to Accounting Manager of the Kansas City Office of the
18 Commission Staff. In that position, I was responsible for all utility audits
19 performed in the western third of the State of Missouri. During my service with
20 the Missouri Public Service Commission, I was involved in the audits of
21 numerous electric, gas, water and sewer utility companies. Additionally, I was
22 involved in numerous fuel adjustment clause audits, and played an active part
23 in the formulation and implementation of accounting staff policies with regard

1 to rate case audits and accounting issue presentations in Missouri. In 1979, I
2 left the Missouri Public Service Commission to start my own consulting
3 business. From 1979 through 1985 I practiced as an independent regulatory
4 utility consultant. In 1985, Dittmer, Brosch and Associates was organized.
5 Dittmer, Brosch and Associates, Inc. changed its name to Utilitech, Inc in 1992.

6
7 My professional experience since leaving the Missouri Public Service
8 Commission has consisted primarily with issues associated with utility rate,
9 contract and acquisition matters. For the past twenty-four years, I have
10 appeared on behalf of clients in utility rate proceedings before various federal
11 and state regulatory agencies. In representing those clients, I performed revenue
12 requirement studies for electric, gas, water and sewer utilities and testified as an
13 expert witness on a variety of rate matters. As a consultant, I have filed
14 testimony on behalf of industrial consumers, consumer groups, the Missouri
15 Office of the Public Counsel, the Missouri Public Service Commission Staff, the
16 Indiana Utility Consumer Counselor, the Mississippi Public Service
17 Commission Staff, the Arizona Corporation Commission Staff, the Arizona
18 Residential Utility Consumer Office, the Nevada Office of the Consumer
19 Advocate, the Washington Attorney General's Office, the Hawaii Consumer
20 Advocate's Staff, the Oklahoma Attorney General's Office, the West Virginia
21 Public Service Commission Consumer Advocate's Staff, municipalities and the
22 Federal government before regulatory agencies in the states of Arizona, Alaska,
23 Michigan, Missouri, Oklahoma, Ohio, Florida, Colorado, Hawaii, Kansas,

Mississippi, New Mexico, Nevada, New York, West Virginia, Washington and Indiana, as well as the Federal Energy Regulatory Commission.

DEVELOPMENT OF JURISDICTIONAL REVENUE REQUIREMENT ACCOUNTING EXHIBITS

Q. Have you prepared exhibits which quantify, summarize and incorporate the results of the various recommendations being made by ACC Staff witnesses, other co-consultants as well as yourself?

A. Yes. Mr. Steven Carver and I have prepared Staff Exhibit __ which consists of a series of Joint Accounting Schedules. The noted Joint Accounting Schedules reflect the individual and cumulative results of all the various recommendations being made by or on behalf of the Utilities Division Staff.

Q. Please describe how Staff Exhibit __ has been prepared and organized.

A. Staff Exhibit __ largely follows the style and format of the accounting exhibits prepared by the Company as part of the Standard Filing Requirements. Specifically, Schedule A is the Revenue Requirement Summary, which reflects the cumulative impact of the various revenue, operating expense, rate base and cost of capital recommendations being sponsored by witnesses appearing on behalf of the ACC Staff. Also shown on Schedule A are the values of the various components underlying the Company's revenue requirement recommendation. Thus, one can observe on a summary level basis how the various components of Staff's revenue requirement recommendation contrast

1 with the Company's proposal (i.e., rate base, adjusted operating income, overall
2 cost of capital).

3
4 Q. Does Schedule A – Revenue Requirement Summary also show a required return
5 on a “fair value” rate base?

6 A. Yes, however, such number has simply been “backed into” utilizing the return
7 requirement calculated developed with the Staff's proposed original cost rate
8 base. In a manner consistent with the Company's presentation of a “fair value”
9 return requirement, I have calculated a “fair value” rate base which consists of
10 an average of a Reconstruction Cost New – Depreciated (“RCND”) and original
11 cost rate base. I have developed a RCND net plant in service value by simply
12 applying ratios derived from APS' original cost and RCND plant in service
13 values. Other RCND rate base components were deemed to be equal to their
14 original cost values. As stated previously, I have developed a “fair value”
15 return and “fair value” rate base in a manner thought to be consistent with that
16 developed by APS.

17
18 Q. Please continue your discussion of the development of the Joint Accounting
19 Schedules.

20 A. Schedule B is the Rate Base Summary. In developing Staff's proposed retail
21 rate base I have started by showing APS' proposed jurisdictional rate base by
22 detailed component (i.e., Column A). In Column B of Schedule B I show the
23 sum of all Staff rate base adjustments, and in Column C one can observe Staff's

1 proposed “as adjusted” retail rate base by detailed category. Immediately
2 following Schedule B – Rate Base Summary are a number of supporting
3 schedules which set forth each individual Staff rate base adjustment. Each
4 individual rate base adjustment has a separate designation such as B-1, B-2, etc.
5 Thus, each rate base adjustment identified and presented with a separate “B-__”
6 designation becomes a reconciling item between APS’ and Staff’s rate base
7 recommendation.

8
9 Schedule C is the Net Operating Income Summary. In a manner similar to the
10 rate base schedules, I begin on Schedule C by showing the Company’s
11 “proposed” or “as adjusted” net operating income by major component. The
12 sum of all of Staff’s adjustments to net operating income can be found in
13 Column B of Schedule C, with the support for each income statement
14 adjustment developed on separate schedules designated as Schedule C-1, C-2,
15 etc. Thus, like the rate base schedules, each “Schedule C-__” reflects a
16 reconciling component or adjustment between APS’ proposed net operating
17 income and Staff’s proposed net operating income. Through the remainder of
18 my testimony I will use the terms “Adjustment B-__” and “Schedule B-__” as
19 well as “Adjustment C-__” and “Schedule C-__” interchangeably.

20
21 Schedule D reflects the Company’s as well as the Staff’s proposed capital
22 structure, including the weighted cost of debt, preferred stock and recommended
23 return on equity. Staff’s proposed capital structure and component cost

1 recommendations are sponsored by Utilities Division Staff witness Mr. Joel
2 Reiker.

3
4 **PEAK AND AVERAGE ALLOCATION ADJUSTMENTS**

5 Q. Please describe the first adjustment to APS' proposed retail jurisdictional rate
6 base.

7 A. Ms. Lee Smith, a consultant with the firm of LaCapra Associates also appearing
8 on behalf of the Utilities Division Staff, is proposing that retail jurisdictional
9 rates be designed by employing a "Peak and Average" methodology for
10 allocating production demand-related costs. I will not describe or reiterate
11 herein the arguments espoused by Ms. Smith in support of the employment of
12 the Peak and Average allocation methodology. Suffice it to say, this
13 methodology has the effect of allocating a somewhat smaller amount of fixed
14 production investment and expense to the ACC retail jurisdiction.

15
16 Rate base Adjustment No. B-1 is posted to restate the Company's "as adjusted"
17 or "proforma" retail rate base employing the noted "Peak and Average"
18 allocation methodology. Similarly, income statement Adjustment No. C-1 is
19 posted to restate the Company's proposed "as adjusted" or "proforma" retail
20 operating results. Because we are restating and reflecting the allocation of the
21 Company's "as adjusted" retail cost of service employing the "Peak and
22 Average" allocation methodology, every subsequent "total company"

adjustment which reflects production demand costs which Staff is proposing is therefore allocated utilizing the Peak and Average methodology.

Q. What is the value of allocating rate base and expenses utilizing the Peak and Average allocation methodology versus the Company-proposed 4-CP methodology?

A. The value of the issue will be dependent upon the level of fixed production investment and expense included in the total company cost of service, as well as the authorized rate of return determined to be reasonable. In other words, the value of the jurisdictional allocation issue will rise as more production and investment is included in the total company cost of service and as the overall return found reasonable increases. That stated, the impact of simply revising APS' requested cost of service to reflect the Peak and Average allocation methodology is to reduce APS' requested retail increase by approximately \$5.1 million. The Staff is recommending several adjustments to APS' proposed level of production investment and fixed production expenses. Further, Staff is recommending a lower overall cost of capital. Thus, the value of the Peak and Average allocation issue would be smaller if quantified using Staff's proposed production cost levels and cost of capital recommendation.

REMOVAL OF PWEC RATE BASE AND NET OPERATING EXPENSE

Q. Please discuss your next adjustment to APS' proposed retail jurisdictional rate base.

1 A. The next rate base adjustment found on Schedule B-2 is made to remove the
2 Pinnacle West Energy Corporation (“PWEC”) generation assets from APS’
3 proposed retail jurisdictional rate base. A corollary income statement
4 adjustment is found on Schedule C-2. The arguments and support underlying
5 these adjustments are sponsored by Utilities Division Staff consultant Mr.
6 Harvey Salgo of LaCapra Associates. The calculations I undertake and reflect
7 on Schedules B-2 and C-2 are made at Mr. Salgo’s direction.

8
9 Staff’s primary recommendation is to remove all PWEC investment from rate
10 base, as well as eliminate all PWEC operating expenses from cost of service
11 development. Staff does offer an alternative adjustment to reflect the PWEC
12 generating units in rate base, albeit with other accompanying adjustment also
13 sponsored by witnesses from the consulting firm of LaCapra Associates. I shall
14 discuss and describe this “alternative” recommendation in a later section of
15 testimony.

16

17 **REVERSAL OF WRITE DOWN**

18 Q. Please discuss your next adjustment to APS’ proposed jurisdictional rate base.

19 A. The adjustment shown on Schedule B-3 reverses APS’ proposed reinstatement
20 or “add back” of a write-down to plant in service recorded on the Company’s
21 books in 1999. There is a corollary income statement adjustment shown on
22 Schedule C-3 wherein APS’ proposed amortization of the “add back” to plant is

1 eliminated from revenue requirement consideration. These two adjustments are
2 also sponsored by Ms. Lee Smith..

4 **DEFERRED GAIN ON PACIFICORP SALE**

5 Q. Please describe your next adjustment to APS' proposed jurisdictional rate base.

6 A. As shown on Schedule B-4, I am proposing that the Deferred Gain on the
7 PacifiCorp Sale be reflected as a reduction to jurisdictional rate base. Such
8 funds represent a cost free source of capital to APS, and accordingly, should be
9 utilized as a reduction to rate base.

10
11 Q. What is the source of the cost free funds underlying the items you have referred
12 to as "Gain on PacifiCorp Sale?"

13 A. In 1991 APS entered into several inter-related agreements that encompassed the
14 sale and exchange of generating assets, as well as the consummation of long
15 term power supply and transmission arrangements. There were several
16 interrelated complex long term agreements that were ultimately approved, with
17 certain conditions, by this Commission.

18
19 One element of the noted 1991 power supply agreement provided that APS was
20 to construct for PacifiCorp 150 megawatts of combustion turbines ("CT") that
21 would be interconnected to APS' high voltage transmission system. Such units
22 would be owned by PacifiCorp but operated and maintained by APS. The units
23 were to be constructed and in service by December 31, 1996. APS was to be

1 paid \$20 million upon commercial operation of the noted combustion turbines.
2 According to the Company's response to Data Request No. UTI-12-292,
3 PacifiCorp subsequently determined that it would not require the additional CT
4 capacity, but nonetheless agreed to pay APS the \$20 million that was to be
5 tendered upon construction of the units. It is the \$20 million that APS received
6 from PacifiCorp in January 1997 related to *agreeing* to build CT units which is
7 the source of the cost free funds that exist in the form of, and are recognized on
8 APS' books and records as, the "Deferred Gain on PacifiCorp Sale."

9
10 Q. What is the regulatory treatment to be afforded the noted Deferred Gain on
11 PacifiCorp Sale?

12 A. Pursuant to a settlement entered into between APS and the Utilities Division
13 Staff in 1991 ("1991 Settlement Agreement"), which was ultimately approved
14 by this Commission in Decision No. 57459, the "gain" received from
15 constructing – or eventually merely *agreeing* to construct the combustion
16 turbines for PacifiCorp – is to be amortized for ratepayers' benefit over a ten
17 year period beginning in 2010. The 1991 Settlement Agreement, as well as the
18 ACC decision approving the 1991 Settlement Agreement, does not address the
19 regulatory treatment to be afforded the cost free funds received from PacifiCorp
20 from the time of receipt until they are amortized as a reduction to cost of service
21 beginning in the year 2010.

1 Q. What is the rationale for deferring the amortization of the gain for constructing
2 the combustion turbines until the year 2010?

3 A. The deferral of the amortization of the noted gain until the year 2010 was a Staff
4 proposal. Staff's analysis at the time suggested that the entire transaction was
5 only marginally beneficial to ratepayers on a net present value basis over the life
6 of all elements of the complex transaction. Specifically, Staff's analysis
7 indicated that the transaction was, overall, slightly beneficial to ratepayers.
8 However, the way the entire approximate-30-year transaction was structured,
9 ratepayers would receive the majority of economic benefits from the various
10 transactions during the first ten years following the original implementation of
11 the various transactions. The worst of the economic cost or "detriment" of all
12 the various related transactions was forecasted to occur in the last ten years of
13 the 30-year agreement (i.e., year 2010 through year 2019). Accordingly, the
14 Utilities Division Staff proposed, APS agreed to, and this Commission
15 authorized, the amortization of the gain over a ten year period beginning in the
16 year 2010.

17

18 Q. Since the Utilities Division Staff once recommended, and still supports, the
19 amortization of the gain for the benefit of ratepayers beginning in the year 2010,
20 why should ratepayers begin to receive the economic benefit of a rate base
21 offset for such funds at this point in time?

22 A. First, these are truly "cost free" funds to the Company. If such funds are not
23 utilized as a rate base offset, APS will receive an unwarranted and unnecessary

1 return on such funds. In other words, investors will receive a return on an
2 investment that simply does not exist.

3
4 Second, the noted 1991 Settlement Agreement, and ACC decision approving the
5 settlement agreement, do not suggest, promise or imply that such cost free funds
6 should not be utilized as a rate base offset from date of receipt until the time
7 they are returned, or begun to be returned, to ratepayers. Admittedly, neither
8 the 1991 Settlement Agreement, or the ACC decision approving the Settlement
9 Agreement, state specifically that the noted “gain” can or should be used as a
10 rate base offset until such time that the funds are amortized for ratepayer
11 benefit. But simple equity would suggest that since such funds are “cost free”
12 to the utility, the Company should not be entitled to earn a return on such “cost
13 free” funds. Accordingly, it is both appropriate and equitable to utilize such
14 funds as a rate base offset at this point in time – even though the amortization
15 benefit to ratepayers will not begin until the year 2010.

16
17 Finally, beyond the equity argument for rate base recognition noted above,
18 reflection of such funds as a rate base offset would be in compliance with the
19 intentions of the ACC Staff in 1991 when collectively it was making its
20 recommendations to this Commission regarding the entire complex transaction.
21 When analyzing the complex transaction, and specifically what “costs” and
22 “savings” were expected from the entire transaction, the Utilities Division Staff
23 assumed that 100% of the gains from the construction of PacifiCorp combustion

1 turbines, as well as other sale transactions, would be passed on to ratepayers. In
2 the case of the gain on the construction of the combustion turbines, Staff
3 recommended, and included within its model analyzing the entire transaction,
4 that the benefit of *the amortization* of the gain would occur over a ten year
5 period beginning in the year 2010. Additionally, however, Staff assumed and
6 included within its model analyzing the transaction, that the cost free funds
7 derived from various “gains” occurring from the complex transaction (i.e., gains
8 from CT construction as well as other elements of the transaction) *would be*
9 *utilized as a rate base offset from date of receipt until returned in their entirety*
10 *to ratepayers.* In other words, from the Staff’s perspective, it was always
11 envisioned and recommended that such gains would be used as a rate base
12 offset.

13
14 Q. Are you certain that it was Staff’s position that the gains from the construction
15 of PacifiCorp CTs and other transactions were to always be reflected as a rate
16 base offset?

17 A. Yes. I was one of the Staff’s witnesses regarding the PacifiCorp transaction in
18 1991. More specifically, I prepared the economic model which incorporated the
19 assumptions and recommendations of all Utilities Division Staff witnesses
20 appearing in the 1991 docket. Further, I was the Utilities Division Staff witness
21 who addressed the regulatory treatment being recommended for the “gains” for
22 the construction of the CTs as well as other elements of the transaction. APS
23 was arguing for retaining or sharing the “gains” from various elements of the

1 transaction. Staff's position, as testified to by me, was that 100% of such gains
2 should be passed along to ratepayers. Admittedly, the significant argument
3 addressed in testimony surrounding the regulatory treatment of the "gains" was
4 whether the gains should be "shared." However, it is clear from an exhibit
5 presented in the 1991 docket that Staff always envisioned that any cost free
6 capital arising from "gains" being derived from the various transactions should
7 be immediately reflected as a rate base offset, even if the actual return to
8 ratepayers through amortization as a reduction to the cost of service was not to
9 occur until sometime in the future. Thus, in summary on this point, it was
10 always the Staff's intention that any "gain" from any transaction arising from
11 the PacifiCorp agreement should be assigned in its entirety to ratepayers, and
12 further, that any cost free funds existing in the form of such "gains" should be
13 reflected as a rate base offset until such funds were returned to ratepayers in
14 their entirety.

15
16 Q. Do you know why APS did not reflect the gains for constructing the PacifiCorp
17 CTs as a rate base offset?

18 A. According to the Company's response to Staff Data Request No. UTI-1-66,
19 APS excluded such funds "[i]n accordance with the 1991 Cholla 4 Order
20 (Decision No. 57459)."

21
22 Q. Does Decision No. 57459 prescribe or order that the gains for constructing the
23 PacifiCorp CTs be excluded from rate base development?

1 A. As stated previously, no. In this regard, as a follow up to the response given by
2 APS to Staff Data Request No. UTI-1-66, I asked in Staff Data Request No.
3 UTI-7-224 what “specific language of any ACC order [APS] relied upon to
4 conclude that such gain should be excluded from retail rate base development.”

5 The Company’s response stated:

6 In Decision No. 57459 the ACC explicitly ordered that “the
7 agreement presented to the Commission by Arizona Public
8 Service Company and Staff, and which is attached hereto, is
9 hereby approved as if fully set forth herein.” Item No. 3 of the
10 Agreement of Settlement and Stipulation attached to the
11 Decision specified that:

12
13 “APS will amortize the Combustion Turbine payment above the
14 line over ten years beginning in 2010. The parties agree that the
15 Commission need not make a determination at this time of the
16 proper allocation between ratepayers and shareholders of any
17 damages won by PacifiCorp, or agreed to by paid [SIC] by APS,
18 for any failure of APS to perform in the construction or operation
19 of Combustion Turbines.”

20
21 APS has consistently interpreted the above language to mean that
22 the rate base deduction for the unamortized balance of the
23 amount received would also begin in 2010, rather than beginning
24 on the date of receipt.

25
26 As evidenced from the language quoted from the 1991 Settlement Agreement
27 above, there is no Commission directive that the payments received for
28 constructing the PacifiCorp CTs be *excluded* from rate base development.
29 Accordingly, I submit that APS has simply been *misinterpreting* the above-
30 quoted language when coming to a conclusion that the unamortized balance of
31 payments received should not be used as a rate base offset.

1 Thus in summary on this issue, there is no Commission directive to exclude
2 such payments from rate base development until they begin to be amortized in
3 the year 2010. Certainly it was the Utilities Division Staff's intention in 1991
4 that such funds be used as a rate base offset until returned to ratepayers. Finally,
5 these funds are truly "cost free" to the Company. Accordingly, it is equitable
6 and appropriate to utilize such cost free funds as an offset to rate base in this
7 and future APS rate proceedings.

8
9 **ELIMINATE DOUBLE COUNT OF VEHICLE LEASE**
10 **COSTS INCLUDED WITHIN APS' COST OF SERVICE**
11

12 Q. Please continue by describing your next adjustment to APS' proposed rate base.

13 A. APS leased a number of vehicles during the historic test year, the cost for which
14 were accounted for as an "operating lease." When leased assets are accounted
15 for as "operating leases," the rental payment is simply charged to operations and
16 maintenance expense. Under Generally Accepted Accounting Principals, some
17 leases meet criteria that cause them to be recorded as an asset on the lessee's
18 books and records. When leased assets are recognized as assets on the lessee's
19 books, they are referred to as "capital leases." Under "capital lease"
20 accounting, the debt financing underlying the leased asset is also shown on the
21 lessee's balance sheet, and further, "depreciation expense" is recorded on the
22 leased assets.

23
24 Through discovery and discussions with the Company it was revealed that
25 vehicles which were afforded "operating lease" accounting during the historic

1 test year were, at the end of the test year, also recorded and recognized as a
2 capital lease. While it is appropriate to recognize the cost of these vehicles in
3 the cost of service *once*, it is clearly inappropriate and inequitable to include
4 their costs *twice* (i.e., once as operating lease costs/rental payments and again
5 with rate base/depreciation expense recognition). Accordingly, my next rate
6 base adjustment, as reflected on Schedule B-5, removes certain vehicle costs
7 that are reflected within APS' proposed rate base, but which were also recorded
8 as "operating lease" or rental expense during the test year.

9
10 Q. Has the Company acknowledged the need for this adjustment?

11 A. Yes. I believe the Company agrees that such adjustment needs to be made to
12 APS' case as filed.

13
14 Q. Is there a corresponding income statement adjustment?

15 A. Yes. When calculating its proforma depreciation expense annualization
16 adjustment the Company calculated depreciation expense on the approximate
17 \$19 million of rate base (i.e., the capitalized leased vehicles) which I propose to
18 remove on Schedule B-5. Accordingly, in addition to posting the rate base
19 eliminating adjustment found on Exhibit B-5, it is also necessary to remove the
20 annualized depreciation expense on such leased vehicles that is included within
21 the Company's cost of service study. The corresponding adjustment to
22 eliminate related depreciation expense is shown on Exhibit C-5.

1 Finally on this issue, I note that it is my understanding that the underlying debt
2 financing associated with the leased vehicles was included within APS'
3 proposed capital structure. Mr. Joel Reiker, appearing as Staff's cost of capital
4 witness, has also eliminated such vehicle lease debt from the capital structure
5 that he is sponsoring. In short and in sum, the asset/rate base, depreciation
6 expense and financing cost of the vehicles included within APS' cost of service
7 development as "capital lease" components, but which are also recognized as
8 "operating lease" expense during the historic test year, have been excluded from
9 Staff's cost of service model. Staff has left test year actual vehicle "operating
10 lease" expense unadjusted. In so doing, APS is fully compensated for its leased
11 vehicle costs.

12

13 **NET LOSS ON REACQUIRED DEBT**

14 Q. Please describe your next adjustment to jurisdictional rate base.

15 A. APS proposes to include in rate base the balance of deferred losses and deferred
16 gains from reacquiring long-term debt instruments. Specifically, APS proposes
17 to include \$7.5 million of its "net" loss on reacquired debt in rate base. On
18 Exhibit B-6 I propose to eliminate the net loss on reacquired debt included in
19 the development of APS' jurisdictional rate base.

20

21 Q. Is it your intention, or that of the Staff's, that the Company *not* be allowed to
22 recover costs incurred to refinance a higher cost debt instrument?

1 A. No. However, the Staff is proposing traditional recovery of such cost vis-à-vis
2 recognition of higher interest costs associated with the debt instruments issued
3 to refinance the debt instruments that were retired. Specifically, Mr. Joel Reiker
4 appearing on behalf of the Utilities Division Staff has reduced the balance of
5 long term debt outstanding by the net loss on reacquired debt which I eliminate
6 from rate base development on Schedule B-6. Furthermore, Mr. Reiker has
7 added the amortization of the net loss on reacquired debt to bond discount and
8 issuance costs. Reducing the debt balance outstanding by the unamortized net
9 loss on reacquired debt, as well as adding the amortization of the net loss on
10 reacquired debt to bond discount and issuance costs, has the impact of raising
11 the calculated *effective* interest rate on the debt instruments issued to refinance
12 the higher cost debt being retired. Recognition of the effective higher interest
13 rate in this manner has the impact of returning to APS the costs incurred to
14 refinance high cost debt *that is supporting utility rate base investment*. The
15 Company-proposed non-traditional method of including the amortization of the
16 net loss on reacquired debt as an above-the-line operating expense, with
17 attendant rate base recognition of the unamortized net loss, results in all the
18 refinancing costs being allocated to regulated utility operations. Accordingly, I
19 believe Staff's proposed traditional recovery of these costs is more equitable to
20 ratepayers in that it ensures that ratepayers will only pay the cost of refinancing
21 related to debt instruments supporting jurisdictional rate base.

1 **TEST PERIOD REVENUE ADJUSTMENTS**

2 Q. Please describe the adjustments proposed by APS to normalize and annualize
3 test year revenues.

4 A. The Company has proposed several test year revenue adjustments to annualize
5 rate changes, normalize weather conditions and annualize for customer levels at
6 test year-end.

7
8 Q. After reviewing the Company's adjustments, does Staff take issue with any of
9 the proposed adjustments?

10 A. Yes. In its adjustment to annualize customer levels at test year-end, APS has
11 also increased certain Customer Accounts and Customer Service expenses, as if
12 such expenses vary directly with the number of customers served. Mr.
13 Robinson sponsors Attachment DGR-5, Page 4 of 27, which is the summary of
14 his "Pro Forma Adjustment: Annualize Customer Levels to Year-End 2002".
15 At line 14 of this summary, a "Pro Forma Adjustment to Customer Accounts
16 Expense" in the amount of \$361 (thousand) is proposed, based upon the
17 presumption that all non-labor expenses incurred in Accounts 901 through 910
18 vary directly with the number of customers being served. I believe that the
19 direct correlation assumed in the Company's expense adjustment for added
20 customers is unproven, tends to overstate expenses, and thereby understates the
21 profit margins earned by APS when it adds new customers. Accordingly, on
22 Schedule C-4 I reverse that part of APS' proposed customer revenue

1 annualization made to capture certain non-payroll related customer expenses
2 purported to be variable with customers added.

3
4 Q. By removing labor costs charged into its Customer Accounts and Customer
5 Services expense accounts, hasn't the Company addressed any concern about
6 whether such costs are fixed, and thus, not variable with new customers added?

7 A. Certainly the Company's removal of labor costs appears to recognize that APS
8 does not hire new employees each time a new customer is added. In fact, in
9 response to Data Request UTI 3.132, the Company stated, "The exclusion of
10 'Total O&M Payroll' from expenses charged to those FERC accounts (payroll
11 representing 75% of the FERC accounts' total) removes predominantly fixed
12 expenses from the calculations leading to "Monthly Other O&M per Customer".
13 However, some of the non-labor costs in these accounts are also predominantly
14 fixed and should not be treated as variable with each new customer being added.
15 Specifically, APS' non-labor costs in the Customer Accounts and Customer
16 Services accounts do not vary directly with the number of customers being
17 served, and therefore, should not be recognized as an offset to revenues
18 attributable to new individual customers added and considered within the
19 Company's customer annualization adjustment.

20
21 Q. What are the specific types of expenses included in FERC Accounts 901
22 through 910 that APS has treated as directly variable with the number of
23 customers being served?

1 A. Summarizing from the FERC Uniform System of Accounts¹, the following
2 activities and costs are contained within the expense amounts in question:

3 901 Supervision: expenses incurred in the general direction and supervision
4 of customer accounting and collecting activities.

5 902 Meter Reading: expenses incurred in reading customer meters, and
6 determining consumption when performed by employees
7 engaged in reading meters.

8 903 Customer Records & Collection: expenses incurred in work on customer
9 applications, contracts, orders, credit investigations,
10 billing and accounting, collections and complaints.

11 904 Uncollectible Accounts: charged with amounts sufficient to provide for
12 losses from uncollectible utility revenues.

13 905 Miscellaneous Customer Accounts: costs of labor, materials used and
14 expenses incurred not provided for in other accounts.

15 907 Supervision: expenses incurred in the general direction and supervision
16 of customer service activities, the object of which is to
17 encourage safe, efficient and economical use of the
18 utility's service.

19 908 Customer Assistance: expenses incurred in providing instructions or
20 assistance to customers, the object of which is to promote
21 safe, efficient and economical use of the utility's service.

¹ 18 CFR 1.101, FERC Electric Uniform System of Accounts 901 through 910.

909 Informational Advertising: expenses incurred in activities which primarily convey information as to what the utility urges or suggests customers should do in utilizing electric service to protect health and safety, to encourage environmental protection, to utilize their electric equipment safely and economically, or to conserve electric energy.

910 Miscellaneous Customer Service & Information: expenses incurred in connection with customer service and informational activities which are not includible in other customer information expense accounts.

Once labor costs are removed, the remaining expenses in these accounts include operation and maintenance costs for automated customer billing and service systems, accruals to provide for uncollectible accounts, handling of customer service orders, collections and complaints, remittance processing and costs of communications to customers. Many of these costs do not increase as a direct result of adding new customers.

Q. Did you prepare any quantitative analysis to evaluate the Company's assumed correlation between the number of customers served and the level of non-labor customer accounts and customer service expenses being incurred?

A. Yes. In response to Staff Data Request UTI 2-102, the Company provided a summary of its actual non-payroll charges for each year 1998 through 2002 to

each of the FERC Accounts within the Customer Accounts and Customer Service account groupings. This expense information appears in the following table:

Account	<u>Non-Labor Expenses Incurred \$000</u>				
	1998	1999	2000	2001	2002
901	\$112	\$221	\$85	\$186	\$213
902	788	901	1,163	1,214	1,121
903	7,727	9,060	10,780	15,531	15,787
904	3,743	4,778	5,438	7,609	2,680
905	15,606	1,393	761	2,126	1,463
907	31	38	26	18	24
908	570	198	705	708	314
909	423	470	584	884	489
910	106	157	278	133	816
Total \$000	29,106	17,216	19,820	28,409	22,907
Percentage Change		-40.9%	15.1%	43.3%	-19.4%

From this data, one can observe significant fluctuation in expense values between years as well as no consistent pattern of gradual increases that coincide with annual growth in the number of customers being served. Therefore, the APS presumption that these expenses vary directly with the number of customers served is not supported by actual historical data.

Q. If these expense values are evaluated on a per-customer basis, is there any support for the Company's assumption that these costs increase in direct proportion to the addition of new customers?

A. No. In response to Staff Data Request UTI 2-103, the Company provided data indicating the average numbers of customers served for each of these five years. That information indicates annual growth in APS customer levels from 3 to 4

percent annually. When the information regarding non-labor expenses in the previous table is divided by the number of customers served each year, the lack of any direct correlation between the level of customers and the level of these costs is apparent:

	<u>Non-Labor Expense Per Average Customer</u>				
	1998	1999	2000	2001	2002
Customers	777,762	810,339	843,480	874,603	902,096
901	\$0.14	\$0.28	\$0.11	\$0.24	\$0.27
902	\$1.01	\$1.16	\$1.50	\$1.56	\$1.44
903	\$9.93	\$11.65	\$13.86	\$19.97	\$20.30
904	\$4.81	\$6.14	\$6.99	\$9.78	\$3.45
905	\$20.07	\$1.79	\$0.98	\$2.73	\$1.88
907	\$0.04	\$0.05	\$0.03	\$0.02	\$0.03
908	\$0.73	\$0.25	\$0.91	\$0.91	\$0.40
909	\$0.54	\$0.60	\$0.75	\$1.14	\$0.63
910	\$0.14	\$0.20	\$0.36	\$0.17	\$1.05
Total	\$37.42	\$22.14	\$25.48	\$36.53	\$29.45

Q. What is your recommendation regarding the Company's proposed adjustment for customers added through December 31, 2002?

A. I recommend removal of the "Pro Forma Adjustment to Customer Accounts Expense" in the amount of \$361 (thousand), because this element of the Company's adjustment relies upon an unproven assumption that such costs vary directly with the number of customers being served and that assumption is not supported by historical expense trends or the nature of costs in these accounts. ACC Staff Adjustment C-4 has been prepared to include this revision to the Company's proposed adjustment.

1

2

PROPERTY TAX ADJUSTMENT

3

Q. Please continue by describing your next adjustment to test year operating expense.

4

5

A. The adjustment shown on Schedule C-6 is made to reduce the Company's proposed level of ongoing property tax expense. While shown as one adjustment on the noted schedule, there are actually two distinct components to this adjustment. Specifically, one element of the adjustment is to remove a "prior period" payment made and recorded as property tax expense in calendar year 2002. The noted "prior period" payment is related to the settlement of a 2001 New Mexico property tax dispute. The other element of this adjustment deals with the level or amount of "ongoing" Arizona property tax expense to be included within the development of proforma operating expense.

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Q. Please further elaborate on the first element of the adjustment found on Schedule C-6 – the removal of a prior period expense.

16

17

A. According to APS, there was a dispute regarding property taxes to be paid to the Navajo Indian tribe related to production facilities owned by APS, but located in New Mexico. During 2002 the dispute was ultimately settled. The settlement payment in the amount of \$7,545,851 made in 2002, and recorded in its entirety as 2002 property tax expense, was tendered to settle 2001 as well as 2002 property tax assessments. Specifically, \$3,793,668 and \$3,752,182 was paid to settle APS' 2001 and 2002 New Mexico property tax obligations, respectively.

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1 The part of the payment tendered for the 2002 assessment should be considered
2 “ongoing” and included in the development of the test year cost of service (i.e.,
3 \$3,752,182). However, the part of the payment related to the 2001 obligation is
4 a “prior period” expense that should be eliminated (i.e., \$3,793,668). Thus, as
5 shown on Schedule C-6, I have removed the New Mexico property taxes paid
6 during the 2002 test year that is related to APS’ 2001 property tax obligation.
7

8 Q. Please continue by discussing that part of your adjustment that relates to
9 reflecting an “ongoing” level of Arizona property tax expense.

10 A. First, I would note that it is my proposal to simply reflect as an ongoing level of
11 property tax expense the actual Arizona property taxes assessed and partially
12 paid during 2003. Specifically, in November 2003 APS was officially billed for
13 approximately one-half of the property taxes assessed for calendar year 2003.
14 The remaining half of 2003 property taxes will be paid in May 2004. However,
15 it is the total assessed amount for 2003 that I am proposing to reflect as
16 “ongoing” for cost of service development.

17 My proposal contrasts with APS’ proposal wherein the Company basically
18 applied 2002 tax rates (last known to APS at the time of preparing its filing) to
19 the Company’s proposed end-of-test year plant in service values.
20

21 Q. Please briefly describe the property tax assessment process in Arizona.

22 A. Property taxes “assessed” in any given year are derived from the value of
23 property owned at the end of the calendar year two years preceding the

1 “assessment year.” For instance, 2003 “assessed” property taxes were
2 ultimately derived by considering the property which APS owned at December
3 31, 2001. It should also be noted that only half of 2003 “assessed” property
4 taxes are paid in November 2003. The remaining half of 2003 “assessed”
5 property taxes will be paid in May 2004. Even though not all 2003 “assessed”
6 property taxes are paid in 2003, the total amount of 2003 “assessed” property
7 taxes is accrued as an operating expense during calendar year 2003.

8
9 While the assessment process begins by considering the “book value” of plant
10 as well as materials and supplies, the “book value” of utility assets are
11 translated, pursuant to statutorily derived formulas, into “full cash values.”
12 Further, once the “full cash value” is derived, the “assessed” value is
13 determined, again pursuant to statute, to be 25% of “full cash value.” Once the
14 assessed value has been derived and relayed to the various taxing authorities,
15 individual taxing authorities can develop a specific tax “rate” to be applied to all
16 assessed values within their jurisdiction. While the “full cash value”
17 determination for various classes of utility property has changed *occasionally*
18 over the years, the individual tax “rate” applied to assessed values will change
19 *every* year based on the individual taxing authority’s fiscal needs for the
20 forthcoming year.

21
22 I believe two significant points should be emphasized from the brief explanation
23 of the property tax assessment process in Arizona. First, the derivation of

1 property taxes “assessed” in any given calendar year begins with the
2 consideration of a utility’s “book value” of property *two years prior to the*
3 *assessment year*. Second, while there is an undeniable dependence or linkage to
4 a utility’s “book value” in the property tax assessment process, there is not a
5 pure or *direct* correlation between a utility’s “book value” and the amount of
6 property tax it is ultimately assessed. For again, each taxing authority will set a
7 different tax “rate” each calendar year based upon the cumulative “assessed”
8 value of property within its jurisdiction as well as the fiscal needs of the
9 governmental entity. Thus, from year to year a taxpayer will not necessarily
10 experience a change in property taxes to be paid that is exactly proportional to
11 the change in its “book value” of property.

12
13 Q. Please explain why you believe reflection of 2003 Arizona property tax
14 assessments is reasonable for cost of service development in this case.

15 A. First, the noted 2003 assessed amounts are “actual” amounts. Second, the
16 amounts assessed by the various taxing authorities were obviously calculated
17 utilizing last known “actual” property tax rates. And third, inclusion of such
18 amounts captures the most recently-available assessments, which in turn, reflect
19 the most-recent cumulative fiscal needs of all the property taxing authorities to
20 which APS is obligated.

21
22 Q. What do you find unacceptable in the Company’s approach?

1 A. First, in light of 2003 property tax data now available, it is more precise and
2 equitable to consider this more-current data. Specifically, the composite or
3 “average” property tax rate as a percentage of the assessed value of all Arizona
4 property fell from 9.56% in 2002 (the rate the Company effectively employed in
5 its property tax adjustment) to 9.25% in 2003. I should quickly point out that
6 the 2003 “average” property tax rate was not available to the Company when it
7 was preparing its filing.

8
9 Second, for two years running APS’ “book value,” “full cash value,” and
10 “assessed value” have risen. However, while the three noted “values” have all
11 risen, the composite or “average” Arizona property tax rate paid on assessed
12 property values by APS has *declined*. The net result is that, in total, Arizona
13 property taxes have fluctuated. More specifically, there has not been a direct
14 correlation between changes in APS’ book value of plant and actual property
15 taxes eventually paid – a correlation implicitly assumed within APS’
16 calculations.

17
18 In developing its proforma Arizona property tax level, APS begins with its end-
19 of-test-year plant values. Utilizing historical relationships, APS then derives a
20 “full cash value” and “assessed value” to which it applies the historical 2002
21 average property tax rate. As previously noted, for two years running, the
22 average property tax rate paid by APS to all Arizona taxing authorities has
23 declined. APS’ method basically assumes that property taxes will rise in direct

1 proportion to its investment in utility plant, even though that relationship has not
2 existed – at least for a couple of years.

3
4 I do not believe the method that APS employed would be inappropriate or lead
5 to inequitable results in cases where there is a fairly direct relationship between
6 growth or decline in “book values” and increases or decreases in actual property
7 taxes ultimately paid related to those book values. However, in this case, where
8 the correlation is not that good, and where there is better information now
9 available to consider (i.e., 2003 actual assessments), I believe it is much more
10 precise and equitable to simply utilize 2003 actual property tax assessments for
11 cost of service development.

12
13 Q. Please describe how your adjustment was calculated.

14 A. Referring to Schedule C-6, on lines one (1) through five (5) I calculate the
15 increase in 2003 over 2002 Arizona property tax expense. On line eight (8) I
16 show the removal of the 2001 “prior period” New Mexico property tax payment
17 included as 2002 property tax expense. Line eleven (11) shows the sum of the
18 two noted components of my property tax expense adjustment. In other words,
19 line eleven (11) shows the “net” adjustment to *test year actual* property tax
20 expense recorded. However, because we are reflecting adjustments to APS’
21 proposed *proforma* cost of service, it is also necessary to subtract out APS’
22 proposed increase in test year Arizona property tax expense. This calculation is
23 reflected on a “total company electric” basis on lines twelve (12) through

seventeen (17). Finally, the jurisdictional impact of the property tax adjustment is reflected on line twenty-two (22).

**ELIMINATE NON-RECURRING MAIN FRAME
COMPUTER LEASE COSTS**

Q. Please describe your next adjustment to test year operation and maintenance expense.

A. The adjustment shown on Exhibit C-7 eliminates the costs incurred during the first half of the historic test year associated with leasing a mainframe computer. In answer to Staff Data Request No. UTI-10-265, the Company acknowledged that the mainframe lease which expired in May 2002 was not renewed. Furthermore, in response to Staff Data Request No. UTI-12-291, APS acknowledged that the mainframe that had been leased during the first four months of the historic test year was purchased in April 2002. Because the cost of the purchased mainframe is included within APS' proposed year-end rate base, and proforma depreciation has been calculated on such year-end plant value, it is equitable to eliminate the operating lease expense recorded during the historic test year related to the mainframe computer. Accordingly, on Exhibit C-7 I have eliminated the "non-recurring" mainframe operating lease expense recorded during the historic test year.

FUEL AND PURCHASED POWER EXPENSE

Q. Is the Staff proposing any adjustments to fuel and purchased power expense?

1 A. Yes. On Schedule C-8 I have posted an adjustment to APS' proposed level of
2 fuel and purchased power expense *assuming the PWEC assets are not included*
3 *in the development of jurisdictional rate base.* This adjustment is being
4 sponsored by Mr. Douglas C. Smith of LaCapra Associates.

5
6
7 **ECONOMIC DEVELOPMENT EXPENSES**
8

9 Q. Please describe your next adjustment reflected on Schedule C-9.

10 A. This adjustment removes the test period expenses incurred by APS for
11 Community Relations and Economic Development activities. Such
12 expenditures are discretionary and not required for the provision of regulated
13 electric utility services. These costs provide no direct, tangible benefit to
14 ratepayers, and therefore should not be included in the Company's jurisdictional
15 revenue requirement.

16
17 Q. What activities are undertaken by APS that are the subject of this Staff
18 adjustment?

19 A. The Company engages in and sponsors business recruitment, business retention
20 and expansion, and community development activities in an effort to enhance
21 the economic vitality and viability of the communities it serves in Arizona.
22 Expenditures include the development and maintenance of information for a
23 www.move2az.com website containing comparative statistics for Arizona
24 communities with out-of-state business locations, sponsoring and publishing

1 studies of the business climate in Arizona, and maintaining information about
2 available business sites. If such activities are successful, there is little doubt that
3 APS demands might grow along with the local economy. However, such
4 expenditures to promote local and state-wide economic development raise a
5 regulatory policy issue regarding whether the Company should be allowed to
6 directly charge such costs to its ratepayers.

7
8 Q. If the Commission removes these costs from the APS revenue requirement,
9 won't the Company be discouraged from funding economic development and
10 community relations activities?

11 A. Not necessarily. Even if these costs are not explicitly included in the
12 determination of revenue requirements, APS can continue to incur economic
13 development costs and will benefit between rate case test years from any
14 incremental electric sales and revenues associated with load growth caused by
15 successful economic development efforts. Regulatory lag allows shareholders
16 to retain the profit margins associated with serving new customers between test
17 periods. Notably, utilities routinely incur costs for charitable contributions,
18 political advocacy and civic event sponsorships even though such costs are not
19 chargeable above-the-line for recovery from utility customers.

20
21 Q. Can the Company's Community Relations and Economic Development costs be
22 thought of as discretionary payments to promote the welfare of the local
23 communities being served?

1 A. Yes. And in this sense such costs are analogous to Donations that are required
2 to be charged to a below-the-line account under the FERC Uniform System of
3 Accounts:

4 **426.1 Donations:** This account shall include all payments or
5 donations for charitable, social or community welfare purposes.²
6

7 As an alternative to making these discretionary expenditures, APS could elect to
8 instead make direct donations to community welfare organizations to assist in
9 funding their economic development programs. If made in this way, such
10 donations would be recorded in below-the-line account 426.1 and not be at issue
11 in this proceeding.
12

13 **NUCLEAR DECOMMISSIONING EXPENSE**

14 Q. Is the Utilities Division Staff proposing any modification to APS' recommended
15 level of nuclear decommissioning expense?

16 A. Yes. Mr. Harold Judd of Accion Group is appearing on behalf of the Utilities
17 Division Staff. Mr. Judd has reviewed APS' nuclear decommissioning study.
18 As a result of such review Mr. Judd is proposing some modifications to APS'
19 proposed nuclear decommissioning funding level. The impact of Mr. Judd's
20 proposed changes is reflected within the adjustment shown on Schedule C-10.
21

22 **DEPRECIATION AND AMORTIZATION EXPENSE**

23 Q. Has the Utilities Division Staff reviewed APS' proposed depreciation rates?

² Id. Account 426.1

1 A. Yes. Mr. Michael Majoros with the firm of Snavelly, King, Majoros, O'Connor
2 and Lee was retained by the Staff to review APS' depreciation study. Mr.
3 Majoros is making several recommendations regarding APS' depreciation rates
4 and depreciation accounting. A summary of Mr. Majoros' recommendations is
5 contained within Schedule C-11, which reflects Staff's proposed changes to
6 APS' proforma depreciation expense.

7

8 **ELIMINATE TEST YEAR DEMAND SIDE MANAGEMENT**
9 **CHARGES FOR RECOVERY THROUGH A TRACKING**
10 **MECHANISM**

11

12 Q. Please discuss your next adjustment to test year operating expense.

13 A. On Schedule C-16 I eliminate test year charges for Demand Side Management
14 ("DSM") activities. The Utilities Division Staff, through Ms. Barbara Keene, is
15 proposing that DSM costs be "tracked" or recovered through an automatic
16 adjustor mechanism. While DSM expenses incurred during the test year are
17 being eliminated on Schedule C-25, such adjustment should not be considered a
18 "disallowance" inasmuch as the Staff is simply proposing that such costs be
19 recovered vis-à-vis an adjustor mechanism.

20

21 **ADVERTISING EXPENSE DISALLOWANCE**


22 Q. Please describe your next adjustment to test year advertising expense.


23 A. Staff Schedule C-17 reflects a detailed calculation of an adjustment to remove
24 the expenses incurred by APS in the test year for discretionary advertising that
25 is not required in the provision of safe and adequate service and is of no direct,

1 tangible benefit to ratepayers. The proposed partial disallowance of APS
2 advertising removes the direct and indirect costs incurred for test year image-
3 building advertising and sports team sponsorships that are designed to promote
4 APS as a highly reliable, affordable, customer-friendly and cost-effective
5 company. Such image-building or positioning advertisements are unnecessary
6 if APS actually provides safe and reliable service in a cost-effective manner in
7 its role as the incumbent retail supplier of electric utility services. Further, as
8 the provider of a regulated service in a certificated service territory, there is no
9 reason to undertake the image building advertising that may otherwise make
10 economic sense for a firm selling non-essential goods or services in a
11 competitive open market.

12
13 Q. Please explain the types of messages that are communicated in the advertising
14 that is disallowed in Adjustment No. C-17.

15 A. Most of the objectionable costs relate to the Company's "Simple Things
16 Campaign" that was emphasized throughout the test period. Television, radio,
17 print and outdoor ads were placed to achieve positive imagery for the Company,
18 with the following types of messages or tag lines:

19  At APS, we're doing loads of things to make sure electricity is there
20 when and where you need it. Like securing new sources of electricity to
21 meet Arizona's ever-growing needs.

22  Thanks to APS, you'll never have to worry about things that go bump in
23 the night...Like your toes.

1 ✚ At APS, our Customer Call Center is open day and night. So, you're
2 never left in the dark.

3 ✚ At APS, we do some pretty cool things. Like power your fan for less
4 than 2 cents an hour.

5 ✚ APS – The Power to Make It Happen [tag-line]

6 ✚ You're not thinking about the electricity that powers those video games.
7 That's our job. At APS, we're always thinking about how to keep your
8 electricity affordable and reliable so you can focus on important things
9 like bonding with the people you care most about.

10 In its response to Staff Data Request UTI-1-18, the Company provided copies of
11 advertisements and cost information and stated:

12 Please note that many of the advertisements concern customer
13 service; public notices; customer safety, energy efficiency,
14 information on billing, payment and rate options; and the like.
15 Taken in total, these communications with our customers are
16 directed towards customer service and satisfaction and have led
17 to marked increases in customer satisfaction.
18

19 Q. Does the adjustment you sponsor remove **all** advertising costs that were
20 incurred in the test year?

21 A. No. Staff's adjustment does not remove advertising costs where the message is
22 about customer safety, public notices, energy efficiency, or information on
23 billing, payment and rate options. For example, significant costs were incurred
24 in the test period for the APS "Power Tips" campaign that provided information
25 to consumers about energy conservation on peak demand days, Surepay billing
26 programs, aps.com and online billing, appliance efficiency, the selection of

1 qualified contractors, or electric safety. A review of the first four lines of
2 Schedule C-17 and the related footnotes illustrates how costs for television,
3 print, and radio media placement of APS advertising were distributed between
4 image-building (disallowed) costs and specific (allowed) advertising of tangible
5 benefit to ratepayers because of an information, conservation, efficiency or
6 safety message.

7
8 Q. Why are the costs of advertisements for KNXV Weather, Dodge Theater, and
9 various professional sports teams, as set forth at lines 4 through 9 of Schedule
10 C-17 disallowed on a 50 percent basis?

11 A. APS sponsorship costs represent financial commitments made for charitable as
12 well as public relations purposes. In response to Data Request UTI 1-18, the
13 Company stated:

14 To encourage and support downtown Phoenix re-development the
15 Company has sponsored entities such as the Dodge Theater, the
16 Arizona Diamondbacks, and the Phoenix Suns. Such
17 redevelopment allowed APS to garner additional sales revenues
18 and margins from the above entities, plus margins from those
19 support entities that derived their business from downtown
20 redevelopment (e.g. restaurants), using, in part, already existing
21 APS infrastructure. And in conjunction with these same
22 sponsorships, the Company did a Simple Things Campaign
23 directed at customer service and satisfaction.

24
25 Also, many if not all, sponsorships/advertising contained multiple
26 elements. These included “pure” advertising, public service
27 announcements, charitable programs, environmental or renewable
28 program participation, employee or customer benefits (e.g., free or
29 reduced admission to events), etc. Some, but not all, of the
30 sponsorships/advertising allocated specific costs to each such
31 element. Others charged a lump sum for the entire package of
32 APS benefits.
33

1 Staff's 50 percent disallowance of sports team sponsorship costs is a
2 conservatively generous cost recovery proposal, based upon the mix of
3 "package" benefits received by APS for such expenditures, given the
4 absence of tangible, direct value to ratepayers from Phoenix economic
5 development, charitable programs and free or reduced price admission to
6 events. A review of the Company's stadium/arena advertising and
7 bundled TV and radio messages alone would support disallowance of at
8 least 50 percent of sports sponsorship costs, because an emphasis was
9 placed upon the "Simple Things" campaign messages (i.e., the disallowed
10 image building campaign) in such advertising, as previously discussed.

11
12 Q. Is there any linkage between favorable public opinion about APS service
13 quality and value, in relation to incentive compensation amounts earned
14 by Company management?

15 A. Yes. As explained in Mr. Carver's testimony, one determinant of how
16 much incentive compensation is payable to management is the percentage
17 of customers stating they are "very satisfied" with APS service in
18 responding to customer survey questioning. Image-building advertising
19 can be employed and timed to create goodwill toward the Company and a
20 strengthened perception that informed ratepayers should be "very
21 satisfied" with APS, given the repeated messages about reliability, value
22 and customer responsiveness within the "Simple Things" campaign.

1 Q. Regarding the Company's suggestion that downtown re-development may
2 promote additional sales revenues and margins, shouldn't such
3 promotional costs, if effective, be included in the revenue requirement?

4 A. Probably not. Promotional advertising by energy utilities is often
5 disallowed by regulators as a matter of policy because it may be contrary
6 to conservation and integrated resource planning goals. Further, sales
7 gains made by the electric supplier may be achieved in part from sales
8 losses by the competing regulated natural gas distribution utility.
9 Moreover, it is difficult to determine whether economic development
10 financial participation by a utility is cost effective in relation to sales
11 growth that might be achieved even if economic development activities
12 were left entirely to other private and public entities. In addition, it should
13 be noted that, assuming incremental revenues from customers added
14 exceed incremental cost to provide such service, sales gains made by APS
15 between rate case test periods provide benefits solely to shareholders
16 because regulatory lag does not "capture" the impact of increases in sales
17 margins until the "next" rate case occurs.

18

19 Q. Would APS have a greater interest in promotional advertising and
20 favorable public impressions about the Company if industry restructuring
21 and competition had been implemented as planned in Arizona?

22 A. Yes. Achieving favorable service quality and value impressions among
23 the buying public would be highly desirable in a competitive market and

1 may have influenced company judgments regarding the level and types of
2 advertising purchased in the test period. However, such costs should
3 ultimately be borne out of profits earned through the competitive supply of
4 energy and not the regulated delivery service pricing.

5
6 Q. Please explain your treatment of “Indirect Payroll, Administration and Ad
7 Agency Fees” at lines 12 and 13 of Schedule C-17.

8 A. The advertising elements listed on lines 1 through 10 represent the direct
9 costs of advertising placement paid to vendors during the test period. In
10 addition to these direct costs that are totaled on line 10, APS incurs certain
11 indirect costs for Company personnel and advertising agencies for
12 planning, development and administration of the advertising and
13 sponsorship programs. These indirect overhead costs are disallowed in
14 proportion to the treatment of the direct costs, using the percentage value
15 developed on lines 10 and 11.

16
17 **STATE INCOME TAX CREDITS AND PERMANENT**
18 **BOOK/TAX DIFFERENCES**
19

20 Q. Please describe your next adjustment to APS’ proforma level of income tax
21 expense.

22 A. Within its development of proforma income tax expense, APS has failed to
23 capture 1) the test year savings it achieved by way of Arizona state income tax
24 credits and 2) the test year cost penalty it incurred as a result of *not* being able to
25 deduct certain meals and entertainment expense. The adjustment shown on

Schedule C-18 is therefore made to reinstate the *net impact* of the two items noted.

Q. Was the net impact of the two items reflected within test year actual operating results?

A. Yes. However, the Company's total company and ACC jurisdictional *proforma* cost of service study was developed by simply applying the composite federal and state income tax rate (i.e., 39.5%) to total company and ACC jurisdictional *proforma* above-the-line operating results less below-the-line interest expense that was calculated by multiplying APS' proposed rate base times APS' proposed weighted cost of debt. The Company's methodology had the impact of eliminating the savings recognized during the test year stemming from the Arizona state income tax credits and the cost penalty resulting from the inability to deduct certain "meals and entertainment" expense. It is therefore necessary to reflect an adjustment to capture the net impact of the two noted events.

Q. Please briefly describe what events or transactions give rise to receiving an Arizona state income tax credit.

A. During the test year APS received four separate Arizona state tax credits. First, it received a credit in the amount of \$60,500 related to its hiring of employees within qualified enterprise zones. Second, APS received a credit in the amount of \$1,167,690 stemming from its investment in facilities constructed to control or prevent pollution. Third, the Company received a credit in the amount of

1 \$1,167,690 related to the purchase of coal consumed in generating electrical
2 power in Arizona. Fourth, APS received a credit in the amount of \$1,108,206
3 for its investment in an alternative fuel delivery system for the dispensing of
4 renewable fuels. According to the Company's response to Data Request UTI-6-
5 188, the credit for investing in alternative fuel delivery systems was repealed
6 with an effective date of January 1, 2004. While this repeal date is well beyond
7 the end of the test year, I have nonetheless conservatively excluded this credit in
8 developing the adjustment shown on Schedule C-18.

9
10 Q. Are the "meals and entertainment" expenses which are *not* deductible for
11 purposes of calculating taxable income included as above-the-line operating
12 expenses?

13 A. According to Company representatives, these items do relate to above-the-line
14 test year operating expenses. As previously discussed in testimony, in
15 Adjustment C-17 I have eliminated certain sports and entertainment sponsorship
16 programs undertaken by APS. To the extent that any or all of those expenses
17 eliminated in my Adjustment C-17 are included as test year non-deductible
18 "meals and entertainment" expense, a revision to either Adjustment C-17 or C-
19 18 will be required. As of the time this testimony was to be prepared I had
20 discovery outstanding on this issue. For purposes of developing Adjustment C-
21 17 I have assumed that all of the expense being eliminated within Adjustment
22 C-17 (i.e., the sports/entertainment adjustment) *was* deductible for purposes of
23 developing taxable income.

1 **INTEREST SYNCHRONIZATION**

2 Q. Please discuss your next adjustment to APS' proforma level of income tax
3 expense.

4 A. The adjustment shown on Schedule C-19 is undertaken to synchronize the
5 interest deduction for consideration in the development of Staff's cost of service
6 income tax expense with the jurisdictional rate base and weighted cost of debt
7 being proposed or recommended by various Staff witnesses. This adjustment,
8 which is routinely calculated and adopted by regulatory commissions in utility
9 rate cases, is derived by multiplying Staff's proposed retail jurisdictional rate
10 base times the weighed cost of debt included within Staff's development of the
11 overall cost of capital. To the extent this Commission may adopt a different rate
12 base or cost of capital than that being proposed by the Utilities Division Staff, it
13 would be appropriate to revise this calculation or adjustment for the return and
14 rate base found reasonable by the ACC in this docket.

15
16 **TURN AROUND OF EXCESS DEFERRED INCOME TAXES**

17 Q. Are you proposing any other adjustments to APS' proposed level of income tax
18 expense incorporated within the Company's cost of service?.

19 A. Not at this point in time. I am, however, still investigating the need for an
20 adjustment to reflect the amortization of excess accumulated deferred federal
21 income taxes. I have reserved Schedule C-20 for such an adjustment if
22 forthcoming data indicates that an adjustment is appropriate.

1 Q. What transactions give rise to “accumulated deferred income taxes?”

2 A. Utilizing guidelines set forth as Generally Accepted Accounting Principles
3 (“GAAP”) which are established by the Financial Accounting Standards Board,
4 companies will record receipts and expenditures of monies as either revenues,
5 income, expense or investment. By following GAAP, the transactions are
6 intended to be recorded in a consistent manner following such guidelines so that
7 the various companies’ reported income and investment can be reviewed and
8 compared on a consistent basis.

9
10 The recognition of revenues and expense for financial statement reporting
11 purposes does not always coincide exactly with the development of revenues
12 and expense for purposes of developing current taxable income. The difference
13 in the development of revenues, expense and income for financial statement
14 reporting purposes versus the development of current taxable income gives rise
15 to “book and tax” differences. Some of the differences are “permanent”
16 differences – as in the case of the non-deductible meals and entertainment
17 expense. However, the majority of book and tax differences are merely
18 “timing” differences. For instance, one of the largest recurring book/tax timing
19 differences stems from the development of depreciation expense recognized for
20 financial statement reporting purposes versus that recognized for purposes of
21 calculating current federal and state taxable income.

1 Using a convention commonly referred to as “normalization accounting,” APS
2 as well as virtually all other regulated and unregulated companies, derive an
3 amount of income tax expense shown for financial statement reporting purposes
4 by essentially applying the current federal and state income tax rates to “book
5 income.” To the extent that “taxable income” varies from reported “book” or
6 “financial statement” income because of book and tax *timing* differences, an
7 “accumulated deferred income tax reserve” is established by applying the
8 current federal/state tax rates to the various timing differences. Later, when a
9 timing difference reverses (i.e., taxable income exceeds book income or vice
10 verse), the related accumulated deferred tax reserve established when the timing
11 difference first arose is, likewise, reversed. Thus, under such “normalization
12 accounting,” income tax expense for financial statement reporting purposes *in*
13 *total* will approximately equal “book income” times the current federal and state
14 tax rates. However, the split or distribution of *total reported income tax*
15 *expense* between “current” and “deferred” income tax expense can fluctuate
16 significantly from year to year as book/tax timing differences arise and reverse.

17
18 Q. What has given rise to *excess* accumulated federal income tax reserves?

19 A. The amount of taxes deferred or “reserved” in any given taxable year related to
20 book/tax timing differences is based upon the then-current federal and state
21 effective tax rates. While the current corporate federal income tax rate of 35%
22 has remained fairly constant since the mid-1980’s, up through the mid-1980’s
23 the rate was considerably higher – ranging from 46% to 48%. Specifically,

1 there were depreciation deductions taken for tax purposes for which deferred tax
2 reserves were established assuming that when the timing difference turned
3 around the federal income tax rate would still be 46% or 48%. Since the current
4 federal tax rate is 35%, there exists *excess* accumulated deferred income taxes
5 accrued at 46%/48% that should, nonetheless, be returned to ratepayers vis-à-vis
6 an amortization mechanism.

7
8 Q. Does APS recognize the need for this adjustment?

9 A. From discussions that I have recently held with APS accounting personnel, I am
10 certain that APS conceptually agrees with the need or equity in crediting
11 ratepayers for excess deferred taxes accrued on its books and collected in rates
12 in prior years. However, the Company's position is that there is an exact offset
13 or shortfall to such *excess* accumulated deferred income taxes, and accordingly,
14 no further adjustment to test year cost of service income tax expense is
15 warranted. As stated at the outset of this section of my testimony, I am not
16 posting an adjustment at this point in time as I continue discussions with APS
17 on this complex issue. If at a later point in time I determine that ratepayers have
18 not been, or are not being, credited for *excess* accruals of deferred taxes I will
19 supplement my direct testimony and post an adjustment to test year income tax
20 expense as deemed appropriate.

1 **SCHEDULE 1 TARIFF CHANGES**

2 Q. What is the purpose of the adjustment set forth at Staff Schedule C-21?

3 A. At Attachment DGR-5, page 5, the Company proposes a ratemaking adjustment
4 for the revenue impact of changing certain miscellaneous service charges under
5 its Schedule 1 tariff. The Specific Company-proposed rate changes are
6 described in APS witness Rumolo's testimony starting at page 3. However, as
7 discussed in the testimony of Staff witness Ms. Barbara Keene, different
8 Schedule 1 charge amounts are being proposed by Staff in this Docket.
9 Therefore, it is necessary to modify the Company's adjustment to reflect the
10 revenue impact of Staff's alternative Schedule 1 rate proposals, as shown in
11 Schedule C-21. Ms. Keene is responsible for the Staff rate proposals on this
12 Schedule.

13
14
15 **ACCELERATED AMORTIZATION OF REGULATORY**
16 **ASSETS**
17

18 Q. Is APS proposing to amortize certain expenses that have been deferred pursuant
19 to ACC orders?

20 A. Yes. The Company has eliminated the amortization of deferred costs which,
21 pursuant to a 1996 Settlement Agreement which was subsequently approved by
22 the ACC, will be fully recovered by June 30, 2004. However, APS witness Mr.
23 Donald Robinson notes that other costs have been deferred since the 1996

1 Settlement Agreement. APS proposes to recover such remaining deferred costs
2 over a five year period.

3
4 Q. Are you in agreement with APS' proposed five year amortization of such
5 deferred costs?

6 A. No. The net deferred costs consist primarily of 1) remaining deferred Palo
7 Verde sale/leaseback payments and 2) Net Unamortized Loss on Reacquired
8 Debt. Referring first to the Net Unamortized Loss on Reacquired Debt, as
9 discussed in a previous section of testimony, Staff is proposing to recover such
10 costs vis-à-vis its development of the effective interest rate on bonds issued to
11 retire higher cost bonds. Accordingly, it is not necessary, and indeed, it would
12 be duplicative, to also reflect such costs as an above-the-line operating expense.
13 Further, there is no apparent reason to accelerate the recovery of such deferred
14 costs as APS has proposed. The benefit of retiring such high cost bonds will be
15 realized over the life of the new lower cost bonds. Accordingly, because the
16 Staff has considered such costs in the development of its effective interest rate
17 on long term debt, it is not necessary to also reflect such costs as an above-the-
18 line operating expense – on an accelerated five-year basis as proposed by APS
19 or over the life of any new bonds issued to retire higher costs bonds.

20
21 The other significant deferred costs which APS proposes to amortize over a five
22 year period relates to deferred Palo Verde Sale Leaseback payment. There is
23 approximately twelve years remaining on the Palo Verde Unit 2 lease.

1 Accordingly, I am proposing that deferred Palo Verde lease expense be
2 amortized, or recovered, over the remaining life of the Palo Verde Unit 2 lease.
3 On Schedule C-22 I propose an adjustment to 1) eliminate APS' proposed
4 above-the-line amortization of net losses on reacquired debt, and 2) lengthen the
5 amortization of deferred Palo Verde Unit 2 lease payments from the APS-
6 proposed five year period to the remaining life of the lease – or in other words –
7 twelve years.

8
9
10 **CONTRIBUTIONS TO CIVIC AND CHARITABLE**
11 **ORGANIZATIONS**

12
13 Q. Are you proposing an adjustment to eliminate contributions to any civic and
14 charitable organizations?

15 A. Yes. As shown on Schedule C-23, I am proposing to eliminate contributions
16 charged during the test year to above-the-line operating expense. Such
17 contributions are not necessary to the provision of safe and reliable utility
18 service. Further, contributions can be viewed as serving the same purpose as
19 imagine building advertising which I have previously discussed in testimony.

20
21 Q. Are you suggesting that APS should no longer make voluntary contributions to
22 civic and charitable organizations?

23 A. It is the Company's decision as to whether to continue making such voluntary
24 contributions. However, if made, such contributions should be charged below-
25 the-line and absorbed by shareholders. To include such expenditures above-the-

1 line for cost of service determination places the ratepayers in the position of
2 becoming *involuntary* contributors to such organizations. Accordingly, such
3 expenses should be removed from cost of service development.
4

5 **AMORTIZATION OF GAINS ON SALES OF PROPERTY**

6 Q. Has this Commission historically required that any gains on sales of utility
7 property be shared between shareholders and ratepayers?

8 A. Yes. While there are a few examples of exceptions, it is my understanding, and
9 it has been my observation, that the ACC typically requires that gains on sales
10 of property be shared 50/50 between shareholder and ratepayers.
11

12 Q. Have there been any gains on sales of property in recent years that have not yet
13 been credited to ratepayers?

14 A. Yes. In answer to Data Request No. UTI-105 the Company has identified gains
15 on sales of property that have been deferred for crediting to ratepayers. On
16 Schedule C-24 I propose an adjustment to amortize the ratepayers' portion (i.e.,
17 50%) of such gains over a five year period.
18
19
20
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23

**ALTERNATIVE REVENUE REQUIREMENT
RECOMMENDATION ASSUMING PWEC ASSETS ARE
INCLUDED IN THE DEVELOPMENT OF
JURISDICTIONAL RATE BASE**

Q. Near the outset of your testimony you indicated that, while the Staff's primary recommendation in this case is to remove or eliminate PWEC assets from jurisdictional rate base development, the Staff is also presenting an alternative proposal that reflects inclusion of the PWEC assets in rate base with accompanying adjustments. Please describe the development of Staff's *alternative* rate recommendation that reflects the inclusion of PWEC assets in rate base.

A. Mr. Harvey Salgo discusses and describes Staff's *alternative* revenue requirement recommendation in the event the Commission elects to consider the PWEC assets in the development of jurisdictional rate base. I will not repeat such discussion herein. While I am not the Staff witness responsible for the theory underlying Staff's *alternative* revenue requirement recommendation, I have assisted in the calculation and presentation of Staff's alternative revenue requirement recommendation that incorporates the inclusion of PWEC assets in rate base.

Q. Please describe the development of Staff's alternative revenue requirement recommendation.

A. First, I note that I have prepared an *alternative* Revenue Requirement Summary, *alternative* Rate Base Summary and *alternative* Net Operating Income Summary schedules comparable to Staff's base or primary case that I have

1 designated as Schedule A-Alternative, Schedule B-Alternative and Schedule C-
2 Alternative, respectively. In Staff's *alternative* case, the only difference from –
3 or incremental change to – Staff's primary case is 1) the add back of the PWEC
4 investment to rate base, 2) the add back of expenses related to owning and
5 operating the PWEC assets, and 3) the amortization of lost savings stemming
6 from APS' purchase of Track B power below market prices that ratepayers
7 would otherwise forego absent the noted adjustment if the PWEC assets are
8 included in the development of jurisdictional rate base.

9
10 Turning first to Schedule B-Alternative (Rate Base Summary), one can observe
11 where I simply "added back" the jurisdictional investment in the PWEC assets
12 that were removed from Staff's base case within Adjustment/Schedule B-2.
13 The adjusted rate base values shown on Schedule B-Alternative are carried
14 forward to Schedule A-Alternative (Revenue Requirement Summary).

15
16 On page 2 of Schedule C-Alternative (Net Operating Income Summary), I show
17 the add back of revenues and expenses related to owning and operating the
18 PWEC units.

19
20 Q. In your development of page 2 of Schedule C-Alternative do you merely add
21 back or "reverse" the components that you adjusted in Staff's base case with
22 Adjustment/Schedule C-2?

1 A. No. There are several differences which I shall briefly explain. Starting first
2 with the “revenue” portion of the adjustment, the Commission needs to
3 understand that APS’ PWEC adjustment to the income statement which I
4 essentially reversed on Adjustment/Schedule C-2 consisted of two components.
5 One component consisted of estimated incremental off-system sales margins
6 thought to be achievable and available for crediting to ratepayers if the PWEC
7 units were included in the development of jurisdictional rate base. The other
8 component of what APS designated as a “revenue” adjustment was not really a
9 “revenue” transaction at all. Specifically, as discussed in APS witness Mr.
10 Donald Robinson’s direct testimony (page 29), APS’ PWEC income statement
11 adjustment also effectively imputed the revenue requirement savings that would
12 be achieved vis-à-vis recognition of a more-highly-debt-leveraged/lower-
13 overall-cost capital structure that reflected some \$500 million of additional debt
14 financing that had lower cost, tax deductible interest expense obligations. APS
15 reflected such imputed capital cost savings as additional “revenues” within its
16 PWEC income statement adjustment, even though such savings do not really
17 consist of “revenues.”

18
19 On page 2 of Schedule C-Alternative I have added back the off-system sales
20 margins estimated to be achievable if the PWEC units are included in rate base.
21 However, I have not added back the imputed capital cost savings that were
22 originally removed in Staff Adjustment/Schedule C-2. It is my understanding
23 that Staff cost of capital witness Mr. Joel Reiker is recommending the same

1 capital structure and cost rates regardless of whether the PWEC units are
2 included or excluded in rate base development. Accordingly, it would be
3 inappropriate to “add back” the imputed capital cost savings that were included
4 within APS’ original PWEC income statement adjustment.

5
6 Q. Please continue describing the development of other subcomponents of the
7 PWEC income statement adjustment found on page 2 of Schedule C-
8 Alternative.

9 A. The “Purchased Power & Fuel Costs” adjustment found on line 2 was
10 developed and provided by Mr. Douglas Smith of LaCapra Associates. The
11 amount provided is a somewhat different amount than that posted when
12 “reversing” the Company’s PWEC income statement adjustment as reflected on
13 Schedule C-2. This difference has arisen by virtue of the fact that Mr. Smith is
14 taking issue with some of APS’ assumptions employed in developing fuel and
15 purchased power expense under the alternative “PWEC in rate base” scenario.

16
17 The “Operations and Maintenance” Expense (other than Fuel & Purchased
18 Power) amount merely adds back the expense level that was eliminated or
19 reversed on Schedule C-2.

20
21 The Depreciation and Amortization Expense amount derived on page 3 of
22 Schedule C-Alternative and carried forward to page 2 of Schedule C-Alternative

1 has been developed by applying depreciation rates being proposed by Mr.
2 Michael Majoros to the PWEC plant in service values.

3
4 The property taxes or "Other Taxes" calculated on page 3 of Schedule C-
5 Alternative and carried forward to page 2 of Schedule C-Alternative were
6 developed by applying the 2003 actual composite or average Arizona property
7 tax rate to the assessed value of the PWEC units as developed by APS.

8
9 Finally, Income Tax Expense was developed by applying the composite Federal
10 and State income tax rate to the change in taxable income. Taxable income was
11 developed by considering the various revenue and expense adjustments
12 described above, as well as the additional interest expense deduction that would
13 be available if the PWEC units are included within jurisdictional rate base.

14
15 Q. Please describe the development of Schedule A-Alternative.

16 A. Schedule A-Alternative calculates a revenue requirement by considering the
17 adjustments to rate base and operating income which were calculated on
18 Schedule B-Alternative and Schedule C-Alternative, respectively. As shown
19 on line 10, column (c) of Schedule A-Alternative, the net impact of adding back
20 the PWEC investment to jurisdictional rate base and adding back Staff's
21 proposed level of operating and ownership costs, is to increase our
22 recommended jurisdictional revenue level by approximately \$123 million.
23 However, as shown on line 14 of Schedule A-Alternative, Mr. Salgo of LaCapra

1 Associates is also proposing an incremental adjustment to jurisdictional revenue
2 requirement to reflect savings stemming from APS' Track B purchase of power
3 at below market rates.

4
5 **NAC INTERNATIONAL – AFFILIATE CONTRACT FOR**
6 **TRANSPORTABLE DRY SPENT NUCLEAR FUEL**
7 **STORAGE SYSTEMS**

8
9 Q. What is NAC International?

10 A. NAC International ("NAC") is an affiliate of APS that develops, markets and
11 contracts for the manufacture of cask designs for spent nuclear fuel storage and
12 transportation. El Dorado Investment Company is a wholly owned subsidiary
13 of Pinnacle West Capital Corporation. El Dorado Investment Company, in turn,
14 is the majority owner of NAC. Thus, NAC is an affiliate of APS.

15
16 Q. Does NAC transact business with APS?

17 A. [REDACTED]
18 [REDACTED]
19 [REDACTED]
20 [REDACTED]
21 [REDACTED]
22 [REDACTED]
23 [REDACTED]
24 [REDACTED]



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1 Q. [REDACTED]

2 [REDACTED]

3 [REDACTED]

4 [REDACTED]

5 [REDACTED]

6 [REDACTED]

7 [REDACTED]

8 [REDACTED]

9

10 [REDACTED]

11 [REDACTED]

12 [REDACTED]

13 [REDACTED]

14 [REDACTED]

15 [REDACTED]

16 [REDACTED]

17 [REDACTED]

18 [REDACTED]

19 [REDACTED]

20 [REDACTED]

21

22 Q. Should there be any exceptions to the requirement to competitively bid the

23 second and subsequent batches of dry cask storage systems?

1 A. I believe that if APS does not elect to undertake a competitive bid process, the
2 burden should be on APS in future rate cases to demonstrate why the
3 competitive bid process was *not* practical, reasonable or likely to produce
4 benefits for ratepayers. Thus, I am not stating unequivocally that the
5 competitive bid process must be undertaken or will always lead to the least cost,
6 most efficient resolution. But to emphasize – the burden for *not* undertaking the
7 competitive bid process would be on APS – with “all ties” regarding facts and
8 assumptions on the evaluation falling to the ratepayers’ advantage.

9

10 Q. Does that conclude your direct testimony?

11 A. Yes, it does.

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